Terre Haute Competes

August 9, 2017

Dear City of Terre Haute and Vigo County Residents:

Terre Haute Competes, a working group of public officials from the City of Terre Haute, public officials from Vigo County, and business leaders from the private sector, are today issuing a recently completed report that analyzes the County's Commercial Assessed Property Value process, one of five areas of local government operations the group reviewed.

Following a year of data gathering, research, meetings, and discussion with stakeholders, including community leaders and local and state officials, regarding elements of the Commercial Property Tax Assessment process, we have arrived at the following conclusions:

1. We believe that the current assessment process is under assessing commercial property and that it is costing the City of Terre Haute and Vigo County millions of dollars in revenue.
2. We have reviewed data on the required ratio study and the location cost multiplier ("LCM") that indicates the current assessment process is not accurately assessing commercial property.
3. We are recommending that the City and County hire an independent, third-party to review the current assessment process to determine whether the process is systematically under-assessing commercial property and, if so, to engage the Indiana Department of Local Government Finance to resolve the issue.

The full report is attached.

Sincerely,

Paul Thrift
Steering Committee Chair
Terre Haute Competes

Scott Womack
Commercial Assessed Value Study
Team Chair
Terre Haute Competes

Terre Haute Competes
Project Recommendation Form

The purpose of this Project Recommendation Form is to provide a summary of our research regarding a specific cost savings or service improvement project and to recommend next steps, if any. At this stage, the recommendation is preliminary and subject to further review by the Terre Haute Competes Steering Committee.

1. **Cost Savings or Service Improvement Project Name**

Commercial Assessed Value process review

2. **Study Team Members**

Chair

Scott Womack

Other Team Members

Brad Anderson, Jerome Case, Bart Colwell, Dan Doan, David Haynes, John Lukens, Chip Miller Don Morris, and Bill Olah

Project Support Lead

Nick Weber and Skip Stitt

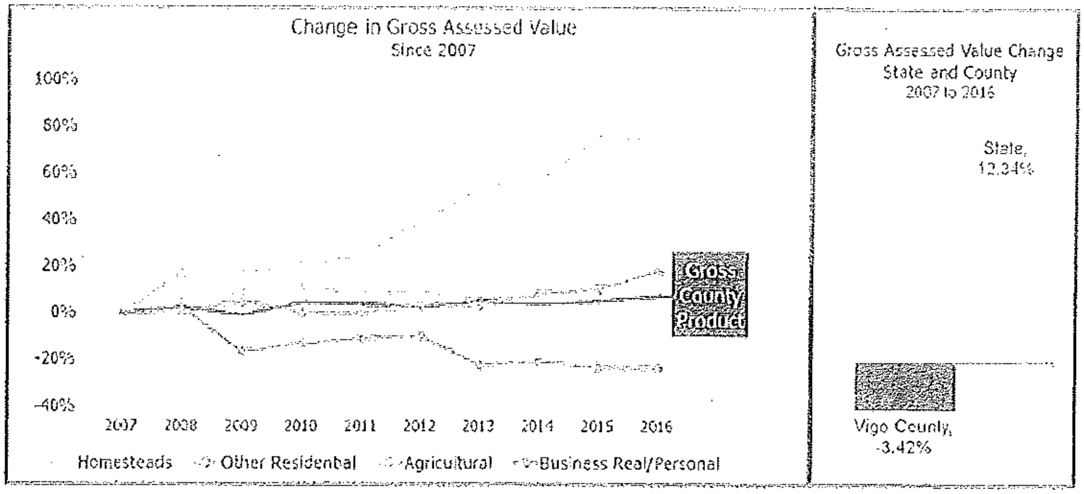
3. **Brief Description of the Project**

Some in Terre Haute and Vigo County have been concerned that commercial property has been under-assessed and, therefore, is not generating the local property tax revenue it otherwise should. If accurate, this results in less revenue to fund government services. Moreover, it proportionally shifts the tax burden away from commercial property taxpayers toward other classifications of taxpayers.

As part of a statewide review, the Indiana Legislative Services Agency produced a snapshot analysis of all 92 counties' property tax environments. The chart below notes the overall drop in Vigo County assessed value over a 10-year period, with the most substantial drop occurring in commercial property assessed value and the largest increase occurring in agricultural land value.[1]

[1] The Assessor does not assess agricultural land; rather, the State sets the value.

From 2007 to 2016, Vigo County gross assessed value decreased by 3.4%, compared to 12.3% growth, statewide. The change in county gross AV trails the 7.6% growth in the gross county product for the same period. Agricultural property has increased by the largest percentage while business property has declined by the largest percentage over the period.



Gross County Product is the value of all the finished goods and services produced within the county. Source: IHS Global Insight. 2

This Terre Haute Competes project did not focus on individual properties and did not seek to determine if individual sites were assessed "too high" or "too low." Therefore, this recommendation does not highlight individual properties or the assessed values associated with them. Rather, the purpose of this effort was to review whether elements of the Vigo County *assessment process* could be contributing to the concerns expressed regarding commercial property assessments. The project did not seek to determine the purpose or intent associated with any assessment-related decisions.

The Study Team selected the following counties for use as comparison communities: Allen, Montgomery, Tippecanoe and Wayne.

4. **Key Research Findings**

Property assessment is a complex, opaque process involving Indiana constitutional law, state statutes, agency regulatory rules, and local elected official activity and discretion. It uses complex procedures and leads to difficult-to-understand outcomes. While the Terre Haute Competes research effort has shed some light on aspects of the process, much of it remains consigned to a world only a few have mastered.

As a starting point, it is helpful to understand a few basic Indiana assessment facts and definitions:

- Property is to be assessed using a "Market Value in Use" standard--- *true tax value* does <u>not</u> mean *fair market value*

[2] Legislative Services Agency, *2016 Property Tax Report*, October 2016

  - The "Market Value-in-Use" of a property is for its current use, as reflected by the utility received by the owner or by a similar user, from the property.
- Assessment methods include cost, sales, and income approaches – with the cost approach generally the most common.
- Setting the assessed value of a recently sold property to its sales price so that it matches the "market" is called Sales Chasing.
  - Sales Chasing is not allowed in Indiana—assessed value should NOT rise <u>merely</u> because a property sold for more than it was assessed
    - Indiana adheres to the International Association of Assessing Officers policy regarding sales chasing
  - If a property assessment is changed to match a sales price <u>only</u> because it sold, it is considered sales chasing in Indiana
  - Sales, however, can trigger an increase in AV if they expose missing information
- Every year, the Assessor must reassess approximately 25% of the parcels in the county, thus completing a reassessment cycle for all parcels every four years.
- Every year, the Assessor must perform a sales ratio study, which compares similar types of properties sold the previous year to the assessed value of those properties at the time of sale. This ratio study is designed to identify market trends that might otherwise go unnoticed in a four-year reassessment cycle.
  - Ratio studies are broken down by property type/classification and location
  - Ratio studies can produce trending "factors" which are applied to the assessed value and can raise (factor >1.00) or lower (factor <1.00) it
  - Trending is not required to occur if the ratio study does not support it

Because this effort was focused on systemic issues rather than targeting specific commercial property sites, and because reassessment only occurs for 25% of all parcels each year, the decision was made to spend time on areas of the assessment process that happen regularly and which affect assessed valuations for all commercial parcels. Therefore, two areas where extensive analysis occurred were:

1. Ratio Studies
2. Location Cost Multipliers

1. <u>Ratio Studies</u>

Ratio studies are not as well understood as the reassessment process, but they occur every year and can have a direct impact on assessed value.[3]

Sample Size

Ratio studies are designed to determine the variation, on a large scale, between sale prices and assessed values. The Indiana Department of Local Government Finance ("DLGF") says, "The

[3] For the majority of time during this research, 2016 was the most recent ratio study performed by Vigo County. The work of the 2017 ratio study was underway during the course of this work. On March 23, 2017, the Indiana Department of Local Government Finance ("DLGF") approved the 2017 Vigo County ratio study. The new study will be discussed, but most of the trending data included in this recommendation will cover 2016 and prior years.

county should take the position that all sales are candidates for ratio study…unless 'sufficient and compelling information' can be documented to show otherwise."[4] Despite that guidance, many communities use far less than ½ of a year's sales in their ratio study and can, if areas are sufficiently segmented, use as little as 3%.[5] There is a point when statistical accuracy is not demonstrably improved with the addition of more properties in a ratio study. By way of comparison, however, the peer counties utilized the below percentages of sales in their ratio studies.

	Number of Sales in 2015	Number of 2015 Sales in 2016 Ratio Study	Percentage of Included Sales
Allen	314	65	20%
Montgomery	54	8	15%
Tippecanoe	171	76	44%
Vigo	139	8	6%
Wayne	99	29	29%

As shown, no community in the cohort used a smaller percentage of sales from 2015 in its 2016 ratio study than Vigo County.

Legitimate reasons exist to exclude a sale from the ratio study process, and Assessors are required to make the determination regarding whether those factors exist for each sale. While the factors are numerous, they generally center on whether a factor was present during the sale that prevented the transaction from being a true market-based sale.[6] It is worth noting that, as the International Association of Assessing Officers guidelines point out, "if sales are excluded without substantiation, the study may appear to be subjective."[7]

Ratios

When Vigo County conducted its 2016 and 2015 ratio studies, the process produced nearly identical values for a potential trending factor for commercial improved property – both very close to a ratio of 1.0. The DLGF generally expects to see ratios between .90 and 1.10.

2016	2015
Ratio	Ratio
.9977	.9976

[4] DLGF PowerPoint presentation, *Annual Adjustments & Cyclical Reassessment*, July 2014.
[5] As this project is focused on commercial property assessed value, all references to "sales," "property," "sites," etc. refer to commercial improved property with improvement values of $1,000 or more. At no time were other classes of property reviewed or analyzed.
[6] Reasons to exclude sales from ratio studies include: buyer adjacent, trade, seller points, primary change, relationship, land contract, personal property, physical change, partial interest, court order, partition, charity, or easement. Properties that were assessed using the income approach are also often excluded.
[7] IAAO, *Standard on Ratio Studies*, 2007

A ratio of 1.0 means that the assessed valuations are highly accurate and little to no trending is necessary. In 2015 commercial property was trended up 2 percent and in 2016 down 1 percent. Vigo County commercial property assessed values did not trend up in response to what many industry and civic leaders believed was a growing commercial real estate market. The recently completed 2017 ratio study (using 2016 sales data) produced a ratio of .9896. As a result, the Assessor has informed DLGF that improved commercial property assessed value will have a 1.05% factor (i.e., a 5 percent increase) applied to it for 2017 (pay 2018).

While the factor will marginally increase commercial assessed value in the county, a number of issues around the ratio study are not well understood. For example, only 9 percent of sales from 2016 were included in the 2017 ratio study, which followed only 6 percent of the 2015 sales being included in the 2016 ratio study.[8] Additionally, in the 2017 ratio study, the assessed values for many sales were corrected after the sale was recorded in the Gateway database and prior to its inclusion in the ratio study.[9] Without those changes, the sales selected for the ratio study would have produced a lower ratio when compared to their sales price, resulting in a larger factor (e.g., a larger increase) to be applied to the assessed value for all commercial property in 2017. It is entirely possible that each correction to the assessed values was justified; however, the rationale for the process is opaque.[10]

To further illustrate the impact of the selection of sales for a ratio study, the Study Team sought to understand what the results of a ratio study might be if the entire universe of improved commercial property sales was examined. To accomplish this, we focused on the 2016 ratio study. In it, eight sales were included from 2015 and 19 from 2014. In 2015, there were 139 sales of commercial properties with improvements of at least $1,000. Using that 2015 data set, we rank-ordered the sales based on sale-to-assessed value-ratios and examined the entire set, the middle 80 percent, middle 60 percent, middle 40 percent and middle 20 percent. In each case, the median ratio was between .55 and .59, well below the .9977 ratio reported in the study.[11]

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[8] It should be noted, however, that 2017 is only the second time since 2012 that previous years' sales have not been included in the ratio study. Including previous years' sales is an accepted practice when it is determined too few valid sales occurred in the previous year to perform a valid ratio study.

[9] The DLGF Gateway ratio study website notes: "Data displayed within the online search is based on sales disclosure filings. Data displayed in this search is reported by county assessors and may not completely reflect the signed form. Assessors have the ability to make corrections for use in a ratio study. The data set shown below may reflect any assessor changes. County assessors maintain hard copies of signed forms. These forms may be available upon request to the county assessor." Some changes can be expected following the filing of the sales disclosure form when the property is physically inspected. A common reason is if renovations have occurred on a property but the assessed value was never updated to reflect those changes (but the changes were valued in the sales price). However, to suggest that 100% of the sales used in the ratio study had a change occur relating to the assessed value that was only revealed upon physical inspection after the sale does not seem to fit the oft-cited examples.

[10] DLGF was asked about this situation and indicated they could not give a definitive answer because they do not review the sales disclosure forms (1/2 of the data set in question). However with that qualifier in place, they suggested that they "do not believe every sale in a property class subset will have corrected AV numbers." They "believe the corrected numbers would be more of the exception than the rule."

[11] It is important to remember that this was a *math exercise* and does not include any of the variances, nuances, exclusions or discretion that are purposefully designed into the ratio study process, thus this evaluation technique could not produce a valid ratio study. It does demonstrate, however, that sales with individually high and low ratios are used in the ratio study rather than a "middle" grouping to achieve a ratio close to 1.00. Without clarity about the

Coefficient of Dispersion

In addition to sale-to-assessed value-ratios, another key measurement that is part of the ratio study process and that is commonly used to determine assessment effectiveness is:

- Coefficient of Dispersion ("COD"): The relative dispersion or variability of assessments from the median. For commercial property, it should be between 5%-20%.

The COD should give taxpayers a sense that, on a macro level, the assessment process in a county is producing appropriate values. The COD values, however, are produced as part of the ratio study, and therefore are impacted by the selection of sales included in the study.

For example, from 2012 to 2014, on average 56 sales were included in the Vigo County ratio studies. During that time, the COD was not static and steadily climbed:

COD		
Ratio Study Year	Harrison Twp.	Balance of County
2014	19.5%	18.7%
2013	18.2%	17.4%
2012	15.0%	11.3%

From 2015 to 2017, the average number of sales in the ratio study fell to 20 and the commercial property sales for the whole county were grouped together. During that time, the COD fell from a point very near the suggested 20% limit for the measurement, to a more middle of the road figure.

COD	
Ratio Study Year	Vigo County[12]
2017	11.86%
2016	12.25%
2015	12.20%

As noted earlier, the COD is a measure of the variability of assessments from the median. From 2012-2014, that variability was growing. Beginning in 2015, it retreated, indicating less

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selection of the sales used, however, it is impossible for the outside observer to confirm that sales are not being selected for their ability to create a desired outcome, rather than for their relative representation of the market.

[12] Beginning in 2015, the Assessor no longer broke out any townships separately and therefore treated the entire county as a single market for commercial improved property. Theoretically, a less-striated data set should increase the COD; however, in this case, the COD fell.

variability from the median. Study Team members were not aware of any community-wide issue that could account for this change in the trend. It was noted, however, that the COD fell at the same time 60 percent fewer sales were used in the ratio study.

2. Location Cost Multiplier

The purpose of cost approach assessments is to determine what it would cost to construct a structure or improvement on the site, in the same form as it currently exists. This requires Assessors to analyze a wide variety of inputs (e.g., ceiling height, wall materials, roof construction, floor materials, and other factors) and value them according to pricing manuals adopted by the DLGF. Once a total is determined from the pricing manual as part of a cost approach appraisal, a location cost multiplier ("LCM") is factored in.

The goal of the LCM is to factor in local issues that could increase or decrease the cost of the improvement within the local area. This is analogous to a regional cost of living factor sometimes used by large companies or the government. DLGF sets a LCM for each county in the state. Marion County is set at 1.00, with each of the other 91 counties either above (i.e., meaning it is more expensive than Indianapolis) or below (i.e., meaning it is less expensive than Indianapolis). Vigo County's 2017 LCM is .93.[13]

DLGF does allow counties to produce their own LCM if they so choose. The process involves gathering yearly construction cost data from projects in the county and presenting that to DLGF. Currently, only two counties (Bartholomew and Delaware) do this. Importantly, for both counties the process has resulted in an increase in LCMs.

County	DLGF LCM	Local LCM	Percent Change
Bartholomew	92%	97%	+5%
Delaware	88%	95%	+7%

Multiple members of the Study Team indicated they do not believe construction costs are materially less expensive in Vigo County when compared to Indianapolis as the .93 LCM might suggest. In fact, when we reviewed a different data set compiled by Marshall Valuation Services that sets local multipliers, Indianapolis received a 1.00, while Terre Haute received a 1.01.[14]

A more detailed review is required to determine how much assessed valuation might increase with a higher LCM and what the resulting increase in tax revenue might be. Limitations such as the countywide breakdown of assessment methods, the number of exemptions and deductions that are applied to improved property, and the impact across different classes of property prevent a determination regarding the final value of change in the LCM.

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[13] While LCM can decrease or increase the "manual" value of improvements in cost approach assessments, it is not the only factor that is applied to improvements.

[14] Marshall Valuation Services, October 2016.

Generally speaking, however, a higher LCM would result in higher assessed valuations for cost approach assessed property. Additionally, it is important to remember that LCMs are applied to all improved property assessed using the cost approach, including residential property.

5. Recommendation

Property tax assessment processes in Indiana are complicated, opaque, and not intuitive. Additionally, the combination of state statutes and regulations, coupled with elected official discretion, make the process nearly impenetrable for the non-expert.

Therefore, the Study Team recommends that, if the Steering Committee continues to believe that the commercial property tax assessment system is generally not accurately reflective of the market value in use, it could suggest the City of Terre Haute, Vigo County or Vigo County School Corporation (or any combination thereof):

- Contract with a specialized entity to perform a more thorough review of the data and process. Ideal firms will have strong analytical capabilities and a deep understanding of Indiana property tax assessment guidelines, including the production of ratio studies and/or reassessments for Indiana counties. The scope of services could focus solely on commercial property in Vigo County and examine the recent ratio studies and, if warranted, produce an alternative ratio study for comparison. If a new ratio study is produced, upon review of the new study, the Steering Committee could petition DLGF to review it. It is possible, following its review and other due diligence, that DLGF could order the county to perform a new ratio study with different methods.[15]

- Work with the Assessor to gather the needed data to petition DLGF to create a locally produced LCM. Only the Assessor may request the LCM from DLGF. Even with support in gathering the required data, it is possible the Assessor will need additional funds in the budget to support a fixed duration project of managing the LCM request through the DLGF approval process.

An alternative path forward for this project is to use Terre Haute Competes' review of commercial property assessed values to spur a more public discussion on these issues and create a local dialogue around these topics.

6. Next Steps

Once an entity is selected to manage this issue, a short vetting process of potential vendors can occur, a scope of work can be agreed upon, and a pricing model can be developed.

[15] In 2007, taxpayers in LaPorte County believed the Assessor was engaging in sales chasing and contracted a third party to examine the relevant data. Following a petition to DLGF and a period of three-party discussions (DLGF, LaPorte County officials, and the taxpayers), DLGF ordered the county to undertake a new ratio study without using sales chasing.

7. Timeline

A process to determine local sponsorship of the initiative, find a vendor to perform the work, undertake the project, and (potentially) engage with DLGF around the substance of the issues could take a year or more.[16]

8. Other Issues

It is important to reiterate, this review occurred without regard to the intentions that may or may not have been present and motivating any action or determinations by local officials. Rather, the review was limited to understanding the effect of the assessment process on valuations.

[16] In the LaPorte County case, it was 14 months from initial complaint to DLGF decision.